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Developing a Sustainable Investment Framework in Lao PDR: Broad recommendations

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About IISD

The International Institute for Sustainable Development (IISD) contributes to sustainable development by advancing policy recommendations on international trade and investment, economic policy, climate change and energy, and management of natural and social capital, as well as the enabling role of communication technologies in these areas. We report on international negotiations and disseminate knowledge gained through collaborative projects, resulting in more rigorous research, capacity building in developing countries, better networks spanning the North and the South, and better global connections among researchers, practitioners, citizens and policy-makers.

IISD's vision is better living for all—sustainably; its mission is to champion innovation, enabling societies to live sustainably. IISD is registered as a charitable organization in Canada and has 501(c)(3) status in the United States. IISD receives core operating support from the Government of Canada, provided through the International Development Research Centre (IDRC), from the Danish Ministry of Foreign Affairs and from the Province of Manitoba. The Institute receives project funding from numerous governments inside and outside Canada, United Nations agencies, foundations and the private sector.

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The project included a two week series of bilateral meetings in Vientiane, with policy makers and donors in the investment and development community.

The Climate is Positive

The investment climate of Lao PDR is positive. The 2011-15 National Socio-Economic Development Plan makes sustainable development a priority and commits to achieving the Millennium Development Goals. This sends positive signals to FDI providers. Laos PDR already boasts clear FDI front runners, including hydro-electricity, mining, agriculture, forestry and tourism. The 2009 Investment Promotion Law establishes special economic zones and Calling Lists (projects important to the national economy) that enable provincial governments to develop and promote business plans for locally-significant projects. These measures will help diversify the Laotian economy and channel investment to rural areas. To improve access to international trade, Lao PDR has signed fifteen bilateral trade agreements and is expected to join the WTO in 2012.

If Laos PDR is to capitalize on this positive climate, policy makers and donors need to address these obstacles to sustainable development.

The One Stop Service

Investors report that the One Stop Service has made setting up a business a faster, less costly and more efficient process. Plans are now underway to house this service within the Investment Promotion Department (IPD) and to staff it with representatives of all the line ministries involved in investment decisions.

If the One Stop Service is to be successful the IPD must develop a dedicated liaison framework (including procedures, reporting lines, and dedicated software) to enable these technical staff to work together. The IPD will also need to build policy capacity by providing training in business and investment matters.

Investor Screening

Given the level of speculative investment in mining, agriculture and forestry, an investor-screening methodology to help identify legitimate investors would be very valuable. Such a methodology would also help develop efficient investor facilitation, business linkage and aftercare services.

Calling Lists

Described in the 2009 Investment Promotion Law as "projects that are important for the national economy," Calling Lists allow provincial governments to identify, develop and promote business plans for projects that will be of value at the local level.

IPD representatives in the provinces and their local counterparts will require dedicated capacity building and long-term mentoring on the assessment of project feasibility and the development of business plans.

Provincial government policy-makers require training on how to assess the quality of an investment. They need a better understanding of objectives and of multiplier benefits.

Unraveling Concession Agreements

Many concession investment licenses and agreements were awarded before the 2009 moratorium. Over 2000 concession agreements were issued on agriculture and plantations; over 263 MOUs were signed for mineral prospecting, of which 79 are believed to in exploitation; 70 MOUs have been issued for hydropower and 15 projects are under construction. There are also a large number of overlapping land use concessions involving mining agriculture, plantations, tourism and other activities.

Policy makers and donors need to work on a legally sound and realistic strategy to deal with the very large number of concession agreements.

Given that there is no model contract, each concession agreement is case-specific, with the draft contract often provided by the investor. Model agreements can provide negotiators and policy makers with guidance on how to build environmental, social and governance safeguards into legal instruments. The use of model contracts can also increase certainty and transparency across the macro-investment environment.

The lack of model contracts is giving rise to inconsistency over the time frames for the various activities governed by concession agreements. For mining, the initial phases of activity are exploration, surveying, and feasibility, followed by construction and exploitation. Only the latter two phases are governed by case-specific concession agreements.

In the case of hydroelectric power, a preliminary 12-month MOU authorizes the developer to carry out technical feasibility, environmental and social impact assessments. A project development agreement (PDA) assigning exclusive rights to develop the project is then negotiated. This agreement is based on the government's approval of technical specifications, financial feasibility studies and environmental and social impact assessments. The PDA typically has a term of 18 months, during which the developer is required to establish a special purpose company, to negotiate the concession and power purchase agreements, and to approach potential investors. The PDA is terminated upon the signature of the concession agreement.

For agriculture and forestry, the stages leading up to the concession agreement are case-specific, as formal processes have not been established and decisions are made mostly at the provincial level, where capacity for the evaluation of multiplier benefits and contract negotiation remain low. Because of the pressure for development and investment in many provinces, safeguards on contractual processes and legal certainty are often overlooked.

Stabilisation clauses are included in all concession agreements. These clauses do not reserve the space of policy makers to upgrade environmental, social and governance laws and require the investor to comply with them.

Environmental and social safeguards and the associated legal language are very weak. Concession agreements do not appear to bind the investor to follow the recommendations of the EIA and SIA on which the concession was awarded.

Standards for Environment and Social Obligations in Concession Agreements

Peter Jensen, through the previous Strengthening Environmental Management II project and now the Environmental Management Support Project based at WREA, is working on draft standards for hydro concession agreements. This work must be expanded to include all concession investment sectors. In addition, these draft standards still appear to carry stabilisation clauses which must be corrected immediately.

The Value of Model Concession Agreements

Lao PDR would benefit from model concession agreements as alternatives to those now prepared by investors. Model agreements must be sector specific and provide for different investment ceilings.

Guidance can be found in a number of places:

- International Bar Association Model Mining Agreement
- Hydropower Sustainability Assessment Protocol
- UN Human Rights markers from John G. Ruggie, the UN Secretary General's Special Advisor on Business and Human Rights
- The Model Forest Toolkit of the International Model Forest Network
- The Forest Carbon Partnership facility on reducing emissions from deforestation and forest degradation, forest carbon stock conservation, sustainable management of forests and enhancement of forest carbon stocks (REDD+)
- Organisation for Economic Co-operation and Development (OECD) Guidelines for Cost-effective Agri-environmental Policy Measures

The IISD does not necessarily endorse the findings or views of any or all of the above resources, but proposes them as starting points for an informed debate.

The Environment Protection Fund

The Lao PDR Environmental Management Fund is a component of the International Development Association LEnS Project, which seeks to strengthen institutions and instruments for assessment, monitoring and compliance for environmental and social sustainability. It invests in on-the-ground environmental improvement activities identified in the National Growth and Poverty Eradication Strategy, with emphasis on biodiversity conservation and livelihood enhancement. The Fund, established with the support of the Asian Development Bank, is to become a permanent entity, using Nam Theun 2 Hydroelectric Project revenues to support environmental protection activities.

Stakeholders hope that this fund will invest in capacity building for regulators, including the Water Resource and Environment Authority and the Land Management Authority. They also expect that it will be used to crowd in contributions from the private sector, which could be channelled into increased budgets for regulators.

IISD was unable to determine if participation from private sector and state-owned enterprises is planned for this fund. If it is, IISD sees two issues with its design and objectives:

- Governments cannot crowd in private sector investment for the delivery of public services unless they provide some of the starting capital. When governments show accountability and commitment, private investors will match or exceed government contributions.
- Regulators must not be directly financed by the firms that they are supposed to regulate. This creates a conflict of interest and violates principles of good governance. The Laotian government cannot hold investors who fund government watchdogs to account.

Recording, accounting and reporting on fees and royalties from concession investments

While royalty rates were revised in the 2009 decree on Land Conversion, rates remain well below international market prices.

The bigger issue is how inconsistently these concession fees are collected, received and recorded across the provinces. All of the regulatory agencies consulted during this project cited this as an indicator of weak institutional capacity.

The double redundancy of tax holidays and low cost concessions and the redesign of investment incentives

The redundancy of the tax holiday and no/low cost concessions has to be eliminated so that the Government of Lao DPR can break the cycle of donor funding and generate income to reinvest in sustainable development and in meeting the ambitious goals of its 2011-2015 National Social Economic Development Plan. The plan puts a priority on achieving the Millennium Development Goals (MDGs) and on leaving the Least Developed Country classification behind by 2020. A prerequisite for achieving this will be increased and targeted spending on public services. This spending will require increased fee, tax and royalty revenues from FDI.

This does not mean that Lao PDR should not offer investment incentives, but it should design them to crowd in domestic investors and increase multiplier benefits including environmental stewardship and social progress.

A first step would be to introduce a uniform corporate income tax rate for both domestic and foreign investors. The ongoing Lao PDR tax reforms (to be published in June 2011) are expected to introduce a uniform income tax rate of 25 per cent, which will be a welcome first step. At present, foreign investors are taxed at 25 per cent and domestic investors at 35 per cent.

Tax deductions on investment in public services (such as roads) and capital assets (such as plants, buildings and technical laboratories) is another sensible incentive as these assets will remain in the country when the investor decides to leave.

Investors desire the ability to depreciate assets and governments across the world now offer options on accelerated depreciation. This incentive allows depreciation at a faster rate than is available for the rest of the economy. This can be done in many ways including higher first year depreciation allowances or increased depreciation rates. This strategy helps free up capital for re-investment in the host economy in the medium term.

As construction and infrastructure expansion gain momentum and Laos PDR establishes special export zones, policy makers could contemplate tax credits, tax allowances or even financial assistance for green buildings and green infrastructure. (Tax credits allow a percentage of the investment to be deducted from taxes owed, while investment allowances permit a fixed percentage of an investment to be deducted from taxable profit). Green buildings typically cost 20 per cent more than their energy inefficient and material-intensive alternatives. Could incentives be offered to cover the difference?

Singapore, South Korea, the State of California, the Province of Ontario, Germany, and the U.K. were ground breakers in linking investment incentives to green infrastructure. These have included:

- agreements to purchase electricity from renewable sources
- subsidies for the use of green building materials
- tenders giving preference to suppliers with a proven track record on environmental management and corporate social responsibility
- subsidies for the increased capital costs of energy efficient buildings
- linking employee performance and salary appraisals to good environmental and energy management
- the establishment of public-private partnerships for green infrastructure.

For example, the Arlanda Express in Sweden (the train link between Stockholm Arlanda Airport and the Stockholm city centre) was built and is being operated as a public-private partnership with environmental management and energy efficiency as key priorities.

Education, research and development, re-skilling and up-skilling are identified as priorities in the National Socio-Economic Development Plan 2011-2015, so it is critical to invite FDI providers to participate in building Laotian human capital. Would it be feasible for the Laotian government to meet the training costs for the first two to four years of operation? Could the government co-fund research chairs and exchange programs at universities, the National Science Council and other higher education institutions? Could tax credits and investment allowances be linked to the training of skilled professionals? Such provisions will play a critical role in skills and technology transfer in the medium term. They will also help upgrade the Laotian export mix to include value-added goods and high-skilled services. China employs a range of such incentives to ensure continued up-skilling and technology transfer. Increasingly stringent requirements on technology transfer and patent sharing are taking effect in most of China's development zones.

Investors can also be encouraged to move beyond compliance on their environmental and social performance. Could the Government of Laos meet the certification costs for international standards such as ISO 14001 and ISO 26000, or provide tax deductions for enterprise certification? India's state of Karnataka employs such incentives to encourage green infrastructure and environmental impact mitigation in the development and maintenance of its industrial parks.

Immediate Strategies for Sustainable Investment

There are a number of immediate actions that the IPD can undertake to promote sustainable investment:

- Develop a one page policy statement that lets investors know that sustainable development is a national priority. This document—the public face of the National Sustainable Investment Strategy—can outline the goals of the National Social Economic Development Plan 2011-2015 and affirm the country's desire to attract quality investment.
- Establish a high-level advisory panel on sustainable investment, co-chaired by IPD and key development agencies such as UNDP, to advise on the development and rollout of the National Sustainable Investment Strategy.
- Establish a dedicated working group on sustainable investment at the National Assembly.
- Promote best practices on sustainability performance by investors. Foreign and domestic investors are working on environmental protection and social development initiatives that go well beyond the requirements of the Laotian law. The IPD together with the Chamber of Commerce and other departments can promote best practices on their respective web sites, as well as at investment forums and fairs such as the Lao Business Forum and the Lao-China Business Forum, and in the Laotian press.
- Create a mechanism for public consultation on investment decisions before bidding processes and negotiations start. Tools could include web announcements, public meetings, press releases, dedicated brainstorming sessions with donors and civil society groups, and National Assembly forums.
- Improve the quality of the business matching services being implemented with the Chamber of Commerce.
- Develop business linkages services to help investors employ and train Laotian nationals and buy goods and services made in Lao PDR.
- Develop services to help investors understand the requirements of environmental and social impact assessment and subsequent management plans
- Develop an investor aftercare service to keep in touch with investors already active in Lao PDR and to help them expand and reinvest in other areas and sectors within the country.

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